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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1940

NO. 1047 106

WASHINGTON COUNTY FIRE INSURANCE COMPANY, Washington, Pennsylvania,
Petitioner,

v.

WILLIAM DRISCOLL, Collector of Internal Revenue, 23rd District of Pennsylvania, Pittsburgh, Pennsylvania, Respondent.

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.**

May it Please the Court:

The petition of Washington County Fire Insurance Company respectfully represents to your Honorable Court:

**Summary Statement of the Matter Involved.**

This is an action at law instituted by petitioner in the United States District Court for the Western District of Pennsylvania against respondent to recover income taxes and interest thereon for the calendar years 1928 to 1936, inclusive.

The question presented by the record is one of exemption from income taxation, viz: Was petitioner exempt from the payment of income taxes for the years in question under the provisions of paragraph (11) of a section, identical in each of the Revenue Acts of 1928, 1932, 1934 and 1936, which provided that farmers' or other mutual fire insurance companies shall be exempt if their income is "used or held for the purpose of paying losses or expenses". (Appendix, P. 26).

The facts open for consideration in the Circuit Court briefly were as follows:

Petitioner is a fire insurance company which was chartered by the Court of Common Pleas of Washington County, Pennsylvania, on December 8, 1873, under the provisions of the Pennsylvania Act of April 2, 1856, P. L. 211 (R. 20). It has never issued any stock and there never have been any stockholders (R. 68). It has issued only one kind of insurance policy, viz., for term insurance, the terms ranging from thirty days to five years (R. 67).

The charter provided that the business should be conducted upon the "mutual principle, exclusively", that petitioner was "allowed" to insure on the cash premium system but that "insurance thus effected shall not entitle the insured to membership" nor subject the insured to payment of assessments (R. 20). From the date of its organization in 1873 to 1911 all insurance was issued for a dual consideration, viz., an annual cash premium and a deposit note, the amount of the notes initially constituting the guaranty fund or back log. The necessity to maintain a guaranty fund or back log decreased as the surplus of petitioner gradually increased, so that from 1911 to 1914 deposit notes, as a consideration for the issuance of insurance, were abolished when the property insured was rated or protected (R. 32, 63). They were

further abolished as a consideration for the issuance of insurance in January, 1914 when the property insured was unrated or unprotected. Thus, during the years 1928 to 1936, inclusive, insurance was effected only for a cash premium (R. 63). The use of deposit notes was continued, however, after January 1914 in a few cases (i. e., 16 cases during 1928-1936)—not as a consideration for the issuance of insurance but as a necessary means, in the absence of amending the charter, of enabling petitioner to maintain a technical, if small, membership under the terms of its charter, which provided that insurance effected for merely a cash premium would not entitle the insured to membership. Thus, a few deposit note makers constituted themselves a technical membership beginning in January, 1914.

During the years in question the average number of deposit note makers was 16, the average number of policyholders was 3,000, the maximum amount of deposit notes was approximately $8,700, the average amount of insurance in force was approximately $10,000,000 and the surplus and reserves ranged from $247,113.19 to $464,206.21 (R. 64, 65 and 67). The amount of the deposit notes was not carried as an asset on the books of petitioner after 1910 and no demand for their payment was ever made (R. 65).

Petitioner's income was not used or held for the purpose of paying dividends. It was used or held for the purpose of paying losses or expenses (R. 68). No dividends or returns of any nature were ever paid or made either to the deposit note makers or to the policyholders (R. 67). No assessment has ever been made against anyone (R. 68).

Each of the deposit note makers since January 1914 has been a policyholder. These deposit note

makers elected from their own group a board of directors, which board in turn elected the officers. The personnel of these deposit note makers was determined by the board of directors (R. 64, 65). Thus the deposit note makers have been a more or less self-perpetuating group since January, 1914.

In these circumstances, the District Court concluded that the 16 deposit note makers were not the owners of petitioner during the years here involved (R. 69), that it would be surprising naïveté to think that sixteen individuals could take over the company by each of them scratching his name to a meaningless piece of paper (R. 72), that the policyholders constituted the only group of persons really interested in the company (R. 69), that they were the real members as long as they held policies of insurance, that the company was not to be treated as virtually a stock company (R. 73), that there were not two or more classes of policyholders (R. 69), that petitioner did not use or hold its income for the purpose of paying dividends but "for the purpose of paying losses or expenses" (R. 68), and that it was such a mutual fire insurance company as was entitled to exemption (R. 68).

Under Section 12 of the Pennsylvania Act of April 2, 1856, P. L. 211 (R. 87), a fire insurance company chartered upon the mutual principle exclusively was required to issue certificates of proportionate shares in surplus to member policyholders and under Section 14 of the same Act such company was given the discretion to redeem such certificates with surplus in excess of $250,000. The Circuit Court relied heavily on this $250,000 limit and on the provisions for the issuance and redemption of certificates in determining a fact, viz., the "purpose" of holding income. It held that there was "no doubt" that the surplus was being held "for

the benefit of the members", meaning the 16 deposit note makers (R. 88), because "throughout" the years in question, the amount thereof being "far" in excess of $250,000, the failure to issue and/or redeem such certificates would amount to an abuse of discretion. This Pennsylvania Act, however, was "absolutely" repealed by the Pennsylvania Act of May 17, 1921, P. L. 682, 40 P. S. § 991 (Appendix, P. 30), and almost seven years before petitioner's surplus and surplus reserves reached the mark of $250,000 (R. 67).

The Circuit Court felt that prior to 1911 petitioner was "strictly mutual" (R. 90) but that during the years involved it was not. It also felt that the designation of deposit note makers as members was controlling and that this feature proved that petitioner insured property, even after January, 1914, upon two different bases —one being the consideration of a cash premium and the other being the consideration of a deposit note—and that consequently the business was conducted upon a dual basis which destroyed mutuality (R. 90).

The Circuit Court reversed the findings of fact of the District Court as to the purpose of holding income, as to the nature of the consideration for issuing insurance and as to the conditions under which insurance was issued since January 1914—these reversals having been made without any comment or ruling upon the existence of evidence to support the District Court's findings.

**Jurisdiction.**

1. This Court has jurisdiction to grant the writ of certiorari and to review the case by virtue of the provisions of Section 240 of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stats. 938), and later amendments.

2. The jurisdiction of this Court is also invoked under Section 1141 of the Internal Revenue Code (U. S. C. Title 26, Section 1141).

3. The District Court entered judgment for petitioner on June 27, 1939. Upon appeal by respondent the Circuit Court of Appeals reversed the judgment of the District Court and entered its judgment for respondent on February 27, 1940.

**The Questions to Be Presented to This Court.**

Should the writ of certiorari be granted, the questions to be presented are:

1. Did Congress intend (by the provisions of Section 103 (11) of the Revenue Acts of 1928 and 1932 and Section 101 (11) of the Revenue Acts of 1934 and 1936) to exempt from income taxation only a pure mutual fire insurance company, as such, or rather a type of mutual fire insurance company?

2. May a *de facto* trusteeship, as such, qualify for exemption under such statutory provisions?

**Reasons Relied on for the Allowance of the Writ.**

Your petitioner submits that the writ of certiorari should be allowed in this case because:

I. *The Circuit Court of Appeals has in two respects so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.*

(1) Where the departure, as here, takes the form of reviving, for use in and as an important basis of its opinion, the dead provisions of a repealed state statute, the Circuit Court would seem to have indulged in judicial legislation. Since the wisdom of legislation is not a matter with which courts are concerned, the wisdom of the repeal of legislation is also not a matter of judicial concern. Where a court draws its own line at $250,000 and observes that the holding of surplus in excess of that amount is a legal discretion which may not be abused, and then decides that the continued and unqualified holding of surplus by petitioner of far more than $250,000 during the years 1928 to 1936 leaves no doubt that the purpose was to hold the surplus for the benefit of the holders, it would seem clear that there has been a merger of legislative and judicial powers in the court. Such merger is probably violative of Section I, Article I, of the Constitution and also of the due process of law clause of the Fifth Amendment. *Wayman v. Southard,* 10 Wheat. 1, 46; *License Tax Cases,* 5 Wall. 462, 469; *Prentis v. Atlantic Coast Line Company,* 211 U. S. 210, 226, 29 S. Ct. 67, 69; *Home Building & Loan Association v. Blaisdell,* 290 U. S. 398, 447, 54 S. Ct. 231, 243.

(2) Where the departure, as here, consists of the exercise of an absolute right of review of the findings of fact of the trial court, the Circuit Court would appear

to have disregarded a rule long and firmly established in our system of administering justice. In its opinion the Circuit Court neither commented nor ruled upon the sufficiency of the evidence to support the District Court's findings of fact. In the absence of such comment or ruling, the reversal would appear to be based upon a mere disagreement as to the weight of the evidence.

The District Court found as a fact that the income of petitioner was not used or held for the purpose of paying dividends but was used or held for the purpose of paying losses or expenses. The purpose in doing something is a fact. This fact is highly material, for it differentiates a pure mutual from the type of mutual Congress intended to exempt. The Circuit Court found the purpose of holding surplus (income) to be this, viz: for the benefit of the deposit note makers. There was ample evidence to sustain the District Court's finding.

The District Court also found as a fact that since January 1914 all properties have been insured by petitioner for a single consideration, viz., an annual cash premium. The Circuit Court found that petitioner has insured property since January 1914 for a cash premium and also for a deposit note. Here, too, there was ample evidence to sustain the District Court's findings.

The District Court further found as a fact that a policyholder received the same kind of insurance and paid for it in the same manner as every other policyholder and *regardless* of whether or not he signed a deposit note. The Circuit Court found that insurance policies were issued and received under different conditions, *depending* upon whether or not an applicant signed a deposit note. There was ample evidence to sustain the finding of the District Court.

Where a case is tried by the court without a jury, its findings of fact are not subject to review by the Circuit Court of Appeals if there was any evidence upon which such findings could be made. *Stanley v. Supervisors of Albany,* 121 U. S. 535, 547, 7 S. Ct. 1234, 1237; *Hathaway v. Cambridge National Bank,* 134 U. S. 494, 498, 10 S. Ct. 608, 610; *Dooley v. Pease,* 180 U. S. 126, 131, 21 S. Ct. 329, 331.

II. *When the provisions of the repealed Pennsylvania Act of April 2, 1856, P. L. 211, are ignored and when the reversed findings of fact of the District Court are restored, the decision of the Circuit Court of Appeals is based upon probably untenable grounds.*

(1) The Circuit Court seems to have taken it for granted that only a pure mutual was intended for exemption. If Congress had intended to exempt only a pure mutual, it would have been unnecessary to say anything about the purpose for which income should be used or held. Indeed, a pure mutual is taxable. A pure mutual usually pays dividends to policyholders, and since this is operating for gain, it is not exempt. *MacLaughlin v. Philadelphia Contributionship for Insurance of Houses from Loss by Fire,* 73 Fed. (2d) 582 (certiorari denied 294 U. S. 718, 55 S. Ct. 544). Congress intended to exempt a company, like petitioner, which uses or holds its income from all sources solely for the purpose of paying losses or expenses if it is otherwise mutual. That Congress limited exemption to pure-mutuals is, we believe, an untenable ground.

(2) The Circuit Court deemed the title of membership in the 16 deposit note makers as controlling. It did not, however, go so far as expressly to award the company to these 16 individuals, and yet, if they are the only real and beneficial members, they must be the own-

ers and such an award should be made. The deposit note makers operated petitioner in nowise for their own benefit but solely for the protection and benefit of the policyholders. They so testified. The policyholders were the real members. The exercise of voting and management privileges by 16 deposit note makers was conduct which was not incompatible with the usual conduct of trustees. A *de facto* trust may qualify for exemption. The view that both legal and beneficial interests must unite in policyholders in order for the company to be considered mutual is probably untenable.

WHEREFORE, your petitioner prays that a writ of certiorari issue out of and under the seal of your Honorable Court, directed to the United States Circuit Court of Appeals for the Third Circuit, directing that Court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in the case numbered and entitled *William Driscoll, Collector of Internal Revenue, Defendant-Appellant v. Washington County Fire Insurance Company, Plaintiff-Appellee,* No. 7221 October Term, 1939, and that the said Decree of the United States Circuit Court of Appeals for the Third Circuit may be reversed by your Honorable Court, and that petitioner may have such other and fur- their relief in the premises as to your Honorable Court shall seem meet and just.

And your petitioner will ever pray, etc.

WASHINGTON COUNTY FIRE INSURANCE COMPANY,

By WILLIAM G. HEINER,
*Counsel for Petitioner.*

IN THE

# Supreme Court of the United States

**OCTOBER TERM, 1940**

**NO. .....**

WASHINGTON COUNTY FIRE INSURANCE COMPANY, Washington, Pennsylvania, Petitioner,

v.

WILLIAM DRISCOLL, Collector of Internal Revenue, 23rd District of Pennsylvania, Pittsburgh, Pennsylvania, Respondent.

## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

### I.

### Opinions of the Courts Below.

The opinion of the United States District Court for the Western District of Pennsylvania may be found in 28 Fed. Supp. 224, and also in the Record at R. 61.

The opinion of the United States Circuit Court of Appeals for the Third Circuit may be found in 110 Fed. (2d) 485, and also in the Record at R. 82.

### II.

### Jurisdiction.

Since the jurisdiction of this Court has been set forth in the petition, it is believed unnecessary to restate it here.

## III.

### Statement of the Case.

Since the facts and circumstances have been stated in the petition, it is believed unnecessary to restate them here.

## IV.

### Specification of Errors to Be Urged.

1. The Circuit Court of Appeals erred in reviving, for use in and as a basis of its opinion, the dead provisions of a repealed state statute.

2. The Circuit Court of Appeals erred in exercising an absolute right of revision of the findings of fact of the District Court.

3. The Circuit Court of Appeals erred in holding that petitioner was not entitled to exemption as a mutual fire insurance company within the meaning of Section 103 (11) of the Revenue Acts of 1928 and 1932 and Section 101 (11) of the Revenue Acts of 1934 and 1936.

4. The Circuit Court of Appeals erred in not holding that the income of petitioner was used or held for the purpose of paying losses or expenses.

5. The Circuit Court of Appeals erred in reversing the judgment of the District Court and in entering judgment for respondent.

## V.

## Argument.

*Summary.*

Where a circuit court itself fixes a definite amount as the maximum surplus that can be unqualifiedly held by a mutual fire insurance company without being subjected to the charge of abuse of legal discretion, it has indulged in judicial legislation. It is beyond the reach of a circuit court to exercise an absolute right of review of the findings of fact of a district court. In these circumstances alone, the decision of the Circuit Court of Appeals should not be allowed to stand. The remaining grounds upon which the decision of the Circuit Court is based are probably untenable. Congress specified for exemption a type of fire insurance company which is not necessarily a pure mutual fire insurance company. A *de facto* trusteeship, such as petitioner, may qualify for exemption as a mutual fire insurance association.

### Point I.

*Where a Circuit Court of Appeals Revives, For Use In and As a Basis Of Its Opinion, the Dead Provisions of a Repealed State Statute, It Has Indulged in Judicial Legislation in Violation of the Constitution.*

In determining whether petitioner met the second requirement for exemption, viz., the "purpose" of using or holding its income, the Circuit Court concluded that because the surplus of petitioner "far exceeds this sum" of $250,000 and because no redundancy certificates had been issued and/or paid, its surplus undoubtedly must have been held—not to pay losses or expenses for the benefit of the policyholders but, on the contrary, for the benefit of 16 deposit note makers.

Concededly, a mutual company is one in which the surplus is held for the benefit of its policyholders exclusively. It would seem, then, that the Circuit Court came to the conclusion that petitioner did not meet either the first or the second requirement for exemption because its surplus is not held for the benefit of its policyholders, that its surplus is not held for the benefit of its policyholders because its surplus is held for the benefit of its deposit note makers, and that its surplus is held for the benefit of its deposit note makers because it abused its discretion in not issuing and/or redeeming certificates of proportionate shares in accordance with the provisions of the repealed Pennsylvania Act of 1856.

We believe that this conclusion is based upon judicial legislation and should not be allowed to stand, as in violation of Section 1, Article I, of the Constitution and the due process clause of the Fifth Amendment.

In *Home Building & Loan Association v. Blaisdell,* 290 U. S. 398, 447, 54 S. Ct. 231, 243, this Court said:

> "Whether the legislation is wise or unwise as a matter of policy is a question with which we are not concerned."

To the same effect are the decisions of this Court in *Wayman v. Southard,* 10 Wheat, 1, 46; *License Tax Cases,* 5 Wall. 462, 469; and *Prentis v. Atlantic Coast Line Company,* 211 U. S. 210, 226, 29 S. Ct. 67, 69.

We believe that there is no sense of justice in the judicial selection of the figure of $250,000, relatively small and possibly inadequate, in view of petitioner's outstanding $10,000,000 insurance liability and in view of the well-known enormous increase in the concentration of insurance hazards since the year 1856.

## POINT II.

*Where a Circuit Court of Appeals Exercises an Absolute Right of Review of the Findings of Fact of a District Court, It Disregards a Rule Long and Firmly Established in Our System of Administering Justice.*

The question of the sufficiency of the evidence to support the findings of fact of the trial court is a preliminary question of law reviewable by an appellate court. This question of law, however, should be expressly decided by the appellate court if such findings are reversed, for without an expressed decision on this question of law, such reversal would appear to be based upon a mere disagreement with the lower court as to the weight of the evidence and, if this were the fact, then the appellate court would be constituting itself the trier of facts. Such action would not be due process of law within the meaning of the Fifth Amendment to the Constitution.

In the following instances the Circuit Court reversed the findings of fact of the District Court apparently upon a mere disagreement as to the weight of the evidence:

(1) The District Court found that the income of petitioner "was not used or held for the purpose of paying dividends" and "was used or held for the purpose of paying losses or expenses" (R. 68). The Circuit Court found that the surplus of petitioner was "held for the benefit of the members" (i. e. 16 deposit note makers). The Circuit Court's holding is a reversal of the findings of the District Court for, if petitioner's surplus was held for the benefit of deposit note makers, obviously it was not held for the benefit of paying losses or expenses. There was ample evidence to support the findings of fact of the District Court (R. 47, 52, 53).

(2) The District Court found that "from January 19, 1914, to the present time rated property and unrated

property have been insured for a single consideration, viz., an annual cash premium payable in advance" (R. 63). The Circuit Court found that petitioner has carried on a nonmutual business since that date because it insures property "for a cash premium" and also insures property "for the consideration of a deposit note" (R. 90). The Circuit Court's holding is a reversal of the findings of the District Court for, if all types of property have been insured since January, 1914, for a "single" consideration, it is obvious that there has been no insurance issued for two or more different kinds of considerations. There was ample evidence to support the findings of fact of the District Court (R. 14, 15).

(3) The District Court found that petitioner "has written in each case only one kind of insurance, viz., term insurance for periods ranging from thirty days to five years, and whether the applicant has or has not signed and delivered to plaintiff a deposit note" and that petitioner "has operated in each case since January, 1914, upon the annual cash premium basis, payable in advance, and this is true whether a policyholder has or has not signed and delivered a deposit note" (R. 67, 68). The Circuit Court found that there were two classes of members, each class receiving insurance "under different conditions" (R. 90). Obviously, where "only one kind" of insurance is issued and paid for "in each case" upon the annual cash premium basis and "whether * * * * * * or not" a deposit note has been signed, insurance has not been received by one class of persons under conditions different from another class of persons. All insurance has therefore been issued regardless of notes. To hold that in such circumstances insurance has been received by different classes of persons under different conditions, is a reversal of the findings of fact of the District Court. There was ample evidence to support the findings of fact of the District Court (R. 19).

The above-mentioned facts are not only material to a judgment in this case, but appear to be the very gist of the case. If it be true that the Circuit Court exercised an absolute right of review of these essential facts, then the decision of the Circuit Court should not be allowed to stand, upon the authority of the following cases:

In the case of *Dooley v. Pease,* 180 U. S. 126, 131, 21 S. Ct. 329, 331, this Court said:

> "Errors alleged in the findings of the court are not subject to revision by the Circuit Court of Appeals, or by this court, if there was any evidence upon which such findings could be made."

To the same effect are the decisions of this Court in *Stanley v. Supervisors of Albany,* 121 U. S. 535, 547, 7. S. Ct. 1234, 1237, and *Hathaway v. Cambridge National Bank,* 134 U. S. 494, 498, 10 S. Ct. 608, 610.

And the Third Circuit Court of Appeals itself has held the same way in the case of *Washington & Canonsburg Railway Co. v. Murray,* 211 Fed. 440, 447, where that court said:

> "Where, as here, a case is tried by a judge, the findings of fact by a court are conclusive, unless there was no evidence to support them."

The rule that an appellate court cannot review the findings of fact of a trial court should work both ways. Here, the Circuit Court appears to have exercised an absolute right of review in disregard of the long and firmly established rule. The disregard of such a rule of procedure could hardly be due process of law. Probably it would be well for this Court again to announce this long and firmly established rule and to point out that the rule should work both ways.

## POINT III.

### *Congress Did Not Intend To Exempt a Pure Mutual Fire Insurance Company As Such.*

The Circuit Court held (R. 90) that petitioner operated on a "strictly" mutual basis from 1873 to 1911, but thereafter did not operate "as a mutual". It did not appear to consider the reason why Congress added a proviso to the word "mutual", nor did it appear to pass upon the question of whether a strict or pure mutual alone was intended for exemption. It would seem that the Circuit Court took it for granted that Congress intended to exempt only pure mutuals.

Congress has provided that to be exempt a company must be mutual and also must use "or" hold its income to pay losses or expenses. The word "income" was not limited by Congress and therefore includes income from premiums as well as income from investments. A pure mutual should not hold its redundancy but should return it to policyholders. If it does not return redundancy, it is of course not a pure mutual.

In *Penn Mutual Life Insurance Company v. Lederer*, 252 U. S. 523, 525, 40 St. Ct. 397, 398, Mr. Justice Brandeis said:

> "It is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder."

And yet Congress has said that a company may hold its income (from all sources), which means that it need not return redundancy.

Petitioner is not a strict mutual because it has never engaged in the practice of returning redundancy, but that course of conduct is compatible with the idea of

exemption. When Congress provided that income could either be used "or held" to pay losses or expenses, it gave an option or election to a company to retain or not to retain redundancy. Also, it was not discriminating against strong, in favor of weak, protection for it approved holding income—which means building up a surplus.

When a company engages in the practice of paying dividends—as distinguished from returning redundancy —to policyholders, and paying these dividends out of income from investments, it is being operated with a view to private gain, is not using or holding its income to pay losses or expenses, and obviously is not exempt.

In *McLaughlin v. Philadelphia Contributionship for Insurance of Houses from Loss by Fire,* 73 Fed. (2d) 582, 584 (certiorari denied 294 U. S. 718, 55 S. Ct. 544), it appeared that the company claiming exemption (under similar statutory provisions) had paid dividends. In denying exemption to that company even though it was considered to be a strict mutual, the Third Circuit Court of Appeals said:

(P. 582) "The plaintiff is a mutual fire insurance company largely doing business in Philadelphia."

* * * * * * *

(P. 584) "The findings of the District Court show plainly that the plaintiff's income was used and held, not only for paying its losses and expenses, but for investment for the benefit of its members. Since 1895, the plaintiff has distributed annually to those who have held policies for ten years and more sums equal to 10 per cent. of their premium deposits.

* * * * * * *

"It is not the type of mutual company intended to be exempt from taxation."

Indeed, pure mutual fire insurance companies, as such, are subject to income tax. See Section 208, Revenue Act of 1928, in Appendix, P. 29. It is only when a mutual fire insurance company uses or holds its income for the purpose of paying losses or expenses that it is exempt. It is believed that to limit exemption to pure mutuals is an untenable ground.

Congress intended to exempt from income taxation a mutual fire insurance company which is not operated for private gain but is operated for the purpose of paying losses or expenses. An examination of all of the seventeen paragraphs of Section 103 of the Revenue Act of 1928 (Appendix, P. 25) demonstrates that Congress felt that there are certain kinds of organizations which actually receive income but which do not operate for the purpose of making an income which "inures to the benefit of any private shareholder or individual", but which operate for the purpose of making an income to be used "or held" for the *common education, comfort or protection* of those interested therein. Such kind of organization, not being operated for private gain, is exempt from income taxation because the idea of income taxation is based fundamentally upon the receipt of private gain or profit. The dividends of such corporations and organizations are in kind and not in cash. Not all cemetery companies, for instance, are exempt, but only that type of cemetery company the income of which does not inure to the benefit of any private shareholder or individual. (See paragraph (5), Appendix, P. 25).

## POINT IV.

### *A De Facto Trusteeship May Qualify For Exemption as a Mutual Fire Insurance Association.*

In the Stipulation of Facts filed in the District Court the parties agreed that only those persons executing deposit notes are members (R. 15), but the District Court felt that it could not give full indorsement to this fact, as full indorsement would mean acceptance of a conclusion deemed contrary to law (R. 74). The District Court found (R. 69) that each policyholder is a member of petitioner while his policy is in force, that there were not two or more classes of policyholders, that the deposit note makers were not the owners of petitioner, and that the policyholders constituted the only group of persons really interested in petitioner. The charter of petitioner provided (R. 20) that the business of petitioner "shall" be transacted upon the "mutual principle, exclusively" and that petitioner is "allowed" to insure on the cash or annual premium system, but that "insurance thus effected shall not entitle the insured to membership". In commenting upon the denial of membership to policyholders who paid for their insurance upon the cash premium system, the District Court felt that this denial was "not easily explainable" (R. 73) as it was directly contrary to the provisions of Section 11 of the Pennsylvania Act of April 2, 1856, P. L. 211, which provided among other things that "all persons insured with, and continuing to be insured therein, shall thereby become members during the period they shall remain so insured and no longer, * * *". The District Court held that the denial of membership by the chartering court was "beyond its power and therefore ineffective" (R. 73). The chartering court probably never expected petitioner to completely abolish deposit notes as a consideration for the issuance of insurance; otherwise it probably would not have denied formal member-

ship to policyholders under the exclusive cash premium system.

The Circuit Court of Appeals, however, felt that only deposit note makers were members because petitioner's charter, by-laws and the Stipulation of Facts said so (R. 90).

If there had really been more than one class of policyholders, petitioner obviously would not be a mutual company. In the case of *Baltimore Equitable Society v. U. S.*, 3 F. Supp. 427, 432 (certiorari denied 290 U. S. 662, 54 S. Ct. 77), it apeared that the company had issued policies for term insurance as well as for perpetual insurance. The term insurance policyholders paid a fixed cash premium, had no voice in the management of the company and no right to share in the earnings. The perpetual insurance policyholders were subject to assessment, were entitled to share in the earnings and were entitled to a voice in the management. In such circumstances, the Court of Claims very properly held that "there was no mutuality".

The District Court felt (R. 71, 72) that in the idea that petitioner could be taken over by some 15 or 16 persons "each scratching his name to a meaningless piece of paper is surprising naivete". The Circuit Court seemed to stress title and self-government, as though only a corporate form of organization could qualify for exemption. It seems that petitioner did not sufficiently urge on the Circuit Court the difference between a policyholder, as such, and a deposit note maker, as such, especially after deposit notes were abolished as a consideration for the issuance of insurance. That one person could be a creditor (policyholder) and also a debtor (note maker) at the same time seemed to the Circuit Court to make for two classes of *policyholders,* one sub-

ject to assessment and the other not. A policyholder, as such, is never subject to assessment, for he pays for insurance—at least since January, 1914—upon only the annual cash premium basis.

To award the ownership of petitioner to the deposit note makers, who testified (R. 47, 48, 52) that the company was operated "for the protection of policyholders and the payment of losses" and that deposit notes have been issued since January, 1914, "simply to perpetuate the membership to manage the affairs of the company" and because "the charter provides this must be done", would amount to a gift neither sought nor expected and, indeed, contrary to their belief and intention.

The continued use since January, 1914, of deposit notes has not been an incident of or consideration for the issuance of insurance policies, but simply a necessary means, in the absence of amending the charter, of enabling petitioner to be managed and operated as a mutual according to the terms of its charter while employing the cash premium system exclusively. The Commissioner of Internal Revenue has ruled that the issuance of nonassessable policies exclusively does not destroy mutuality nor is it decisive of exemption (Appendix, P. 30).

Congress has not provided that to be exempt a mutual fire insurance company must be a corporation or some other *de jure* organization. It has used the words "companies or associations". A trusteeship created by act of the parties is an association.

There appears to be no valid reason why petitioner should not be considered at least a *de facto* trusteeship since January, 1914. A few individuals, who were policyholders, took it upon themselves to maintain a technical or formal membership. That is, they declared themselves trustees for the policyholders. Certainly,

the intention of the deposit note makers, according to their testimony, would point to an intention to operate—not for their own benefit but for the benefit of the policyholders. Trustees usually manage the affairs of a trusteeship. Trustees usually do the voting. There is a vast difference between control for one's own benefit and control for the benefit of another. A trustee cannot operate a trust for the trustee's benefit. A trustee has no interest in or equitable ownership of the trust assets. The duties performed by the deposit note makers are not incompatible with the usual duties of trustees. The policyholders are the real members of this company because beneficiaries are the real members of *any* trust. To award both the legal and beneficial interests in petitioner to 16 individuals (and the Circuit Court's decision is tantamount to such an award) would be unfair to the policyholders and unsought by those individuals. It would meet one's sense of justice to rule that since January, 1914, petitioner has been operated for the protection—not gain—of the policyholders exclusively, and that its 16 deposit note makers have been merely agents and trustees for the policyholders. Such a ruling would carry with it the conviction that petitioner is the type of organization intended to be exempt from an income tax which is levied, not on common protection, but on private gain and profit.

Respectfully submitted,

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## APPENDIX.

"EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this title—

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations, (A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and co-operative banks without capital stock organized and operated for *mutual purposes and without profit;*

(5) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which *inures to the benefit* of any *private* shareholder or individual;

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which *inures to the benefit* of any *private* shareholder or individual;

(7) Business leagues, chambers of commerce, real estate boards or boards of trade, not organized for profit and no part of the net earnings of which *inures to the benefit* of any *private* shareholder or individual;

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, education or recreational purposes;

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which *inures to the benefit* of any *private* shareholder;

(10) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses;

(11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses;

(12) Farmers', fruit growers', or like associations organized and operated on a cooperative basis, (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it

has capital stock if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than non-voting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 per centum of the value of all its purchases;

(13) Corporations organized by an association exempt under the provisions of paragraph (12), or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to partici-

pate, directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose;

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;

(15) Federal land banks, national farm-loan associations, and Federal intermediate credit banks, as provided in the Federal Farm Loan Act, as amended;

(16) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident or other benefits to the members of such association or their dependents, if (A) no part of their net earnings *inures* (other than through such payments) *to the benefit* of any *private* shareholder or individual, and (B) 85 per centum or more of the income consists of amounts collected from members for the sole purpose of making such payments and meeting expenses;

(17) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings *inures* (other than through payment of retirement benefits) *to the benefit* of any *private* shareholder or individual, and (B) the income consists solely of amounts received from public taxation, amounts received from assessments upon the teaching salaries of members, and income in respect of investment." *Section 103, Revenue Act of 1928* (Similar provisions *Section 103, Revenue Act of 1932* and *Section 101, Revenue Acts of 1934 and 1936*) (Italics supplied)

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"MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) *Application of title.*—Mutual insurance companies other than life insurance companies, *shall be taxable* in the same manner as other corporations, except as hereinafter provided in this section.

(b) *Gross income.*—Mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

(c) *Deductions.*—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) *Mutual insurance companies other than life insurance.*—In the case of mutual insurance companies

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

(2) *Mutual marine insurance companies.*—In the case of mutual marine insurance companies, in addition to the deductions allowed in paragraph (1) of this subsection, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(3) *Mutual insurance companies other than life and marine.*—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make pre-

mium deposits to provide for losses and expenses, the amount of *premium deposits returned to their policyholders* and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves." *Section 208, Revenue Act of 1928.* (Italics supplied)

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"Neither the extent of the territory in which the company may properly operate nor the fact that it accepts premium deposits instead of assessments is decisive as to its exemption." *Treasury Decision No. 4634* (now incorporated in *Article 101 (11)-1 of Regulations 94 under the Revenue Act of 1938)*

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PENNSYLVANIA ACT OF APRIL 2, 1856, REPEALED.

"The following acts and parts of acts of Assembly are hereby repealed as respectively indicated. The repeal of the first section of an act shall not repeal the enacting clause. Repealed absolutely:— * * * 1856, April 2, P. L. 211; * * *." *Pennsylvania Act of May 17, 1921, P. L. 682, Art. XI, §1101; 40 P. S. §991*

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# In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 106

WASHINGTON COUNTY FIRE INSURANCE COMPANY, WASHINGTON, PENNSYLVANIA, PETITIONER

*v.*

WILLIAM DRISCOLL, COLLECTOR OF INTERNAL REVENUE, 23RD DISTRICT OF PENNSYLVANIA, PITTSBURGH, PENNSYLVANIA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

### OPINIONS BELOW

The opinion of the District Court for the Western District of Pennsylvania (R. 61–74) is reported at 28 F. Supp. 224. The opinion of the Circuit Court of Appeals (R. 82) is reported at 110 F. (2d) 485.

### JURISDICTION

The judgment of the court below was entered on February 27, 1940 (R. 92). Petition for rehearing

was denied April 2, 1940 (R. 98). The petition for a writ of certiorari was filed May 27, 1940. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

### QUESTION PRESENTED

Whether the petitioner was exempt from the payment of income taxes during the years 1928–1936, inclusive, as a "mutual" company "the income of which is used or held for the purpose of paying losses or expenses," under Section 103 (11) of the Revenue Act of 1928 and the corresponding provisions of subsequent revenue acts.

### STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 14–19.

### STATEMENT

The facts before this Court fall into three categories: (1) Findings of the District Court, (2) facts stipulated by the parties, and (3) facts alleged in the complaint which were admitted as true.

(1) The findings of the District Court (R. 62–68) disclose the following facts:

Petitioner is a fire-insurance company which was chartered by the Court of Common Pleas of Washington County, Pennsylvania, on December 8, 1873 (R. 62, Finding 1), under authority of the Act of April 2, 1856, entitled "An Act to provide for the

incorporation of Insurance Companies" (Pennsylvania Laws (1856), No. 236, p. 211). It has its principal place of business in the City of Washington, Pennsylvania, and insures buildings located in Washington and neighboring counties (R. 63, Finding 5).

From the time of its organization down to July 1911 all of petitioner's policyholders were required to execute and deliver deposit notes to the petitioner at the time of making their application for insurance (R. 63, Finding 6, 7). These deposit notes subjected the makers to liability for assessment for losses in such amounts as the directors might determine, not to exceed twelve percent of the face amount of the deposit note maker's policy (R. 62, Finding 3; Exs. C and D, R. 39, 41). From July 1911 to January 1914 rated property was insured by the petitioner for an annual fixed premium; and unrated property was insured for the fixed premium, together with the deposit note of the policyholder (R. 63, Finding 9). Since January 1914 up to the present time, and including the years for which the taxes in question were assessed, all types of property have been insured by the petitioner for a single consideration, that is, a fixed annual premium (R. 63, Finding 10).

Since 1914, the deposit notes subjecting the makers to assessment for losses have been executed only by a few policyholders chosen by the directors of the company and not by the great body of policy-

holders (R. 62, 64, Finding 3, 12). Section IX of the bylaws provides that only those executing deposit notes shall become members (R. 33, Ex. B). These deposit note makers elect the directors from their number and the directors in turn elect the officers from their number and are responsible for the management of the company (R. 64, 65, Finding 15, 16). The policyholders who did not execute the deposit notes are liable for no assessments (R. 68, Finding 29), and there is no provision in the charter or bylaws giving them the right to vote (R. 19, 21, Exs. A, B).

During the years for which the taxes in question were assessed, the number of deposit note makers or members averaged sixteen, and the average number of all policyholders was approximately three thousand (R. 64, Finding 13). During these years the face value of the policies carried by members averaged approximately $66,000 (R. 50, 64, Finding 14), as contrasted with the total amount of insurance in force of approximately ten million dollars (R. 65, Finding 18).

During each of the taxable years in question the petitioner realized considerable income over and above its losses, expenses, and the reserve required by the state law (R. 67, Finding 24). The amounts of net income so realized went to build up a surplus which ranged from some $280,000 in 1928 to nearly one-half million dollars in 1936, the last taxable year in question (R. 67, Finding 23).

(2) The following material facts were stipulated by the parties and corroborated by the uncontroverted testimony of petitioner's witnesses:

The use of deposit notes has been continued since 1914 solely for the purpose of providing a membership entitled to elect the managing officers of the petitioner company (R. 15, Stip. 12). The deposit note appearing on the back of the application is executed only by those applicants for insurance whom the directors determine shall be members (R. 13, Stip. 3). Only those persons who execute deposit notes are members of the petitioner company (R. 15, Stip. 12). The nonmember policyholders have, since 1914, had no right to vote (R. 49). These policyholders receive a standard policy which is the same as that prescribed in the Pennsylvania laws for stock companies (R. 49, 42, Ex. E). They receive this and nothing more (R. 49). There is nothing in the policy that entitles these policyholders to any dividends or subjects them to any liability for assessment (R. 49). They pay an annual fixed premium (R. 49). During the years in question all but two of the sixteen members, that is, the deposit note makers, held an office or some other position with the petitioner company and practically all of them derived income for their services with the petitioner company (R. 50–51).

(3) Material facts which were alleged in the complaint and admitted as true in the petitioner's pleadings were as follows:

Upon the supposition that it was exempt from payment of income taxes, petitioner filed no returns for the years 1928 to 1934, inclusive, until requested to do so by the Collector. Its returns for the years 1935 and 1936 were filed on the due dates. Upon examination of these returns the Commissioner assessed and collected from petitioner all the taxes in question (R. 5). Claims for refund were timely filed for all amounts so paid on the ground that petitioner was exempt from the payment of income taxes under Section 103 (11) of the Revenue Acts of 1928 and 1932, and Section 101 (11) of the Revenue Acts of 1934 and 1936 (R. 6–7). Upon rejection of these claims for refund suit was filed in the District Court (R. 3–9).

The District Court modified the facts as stipulated by the parties and upon its own findings, concluded as matters of law that each holder of a policy was a member of the Company and that there were not two or more classes of policyholders during the taxable years involved (R. 69). Upon such findings and conclusions the court, accordingly, entered judgment for petitioner. The Circuit Court of Appeals reversed the District Court, adopting the view that under the undisputed facts petitioner did not come within the statutory exemption (R. 86, 91).

## ARGUMENT

The only recognized ground upon which petitioner relies for the allowance of the writ is an

alleged departure by the court below from the accepted and usual course of judicial proceedings. We respectfully submit that the Circuit Court of Appeals merely applied the Federal statute to the undisputed facts, and concluded that petitioner was not exempt thereunder. The decision below is correct and there is no basis for further review.

1. Although petitioner has no capital stock and is to that extent similar to the usual mutual company, nevertheless, at least 99% of its business is written at fixed premium rates for persons who are in no sense participants in a mutual enterprise. Only some sixteen policyholders out of a total of more than three thousand policyholders were, in any sense, members or beneficial shareholders of the petitioner with a voice in its management, or interest in its assets. They alone were subject to assessment. The other three thousand policyholders, with whom the great bulk of petitioners' business was done, had none of the rights or duties of members. No assessment could be made against them. Both the Company's charter and policy denied membership to the great bulk of its policyholders and limited membership to the sixteen who had deposited notes in addition to the payment of the cash premiums (R. 15–16, 19, 49–50, 64–65, 73). The court below treated these undisputed facts as sufficient to prevent petitioner from being a mutual company, within the meaning of the statutory ex-

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emption, and we submit that the court's conclusion is correct.

The result reached below is fortified by the fact that the statutes speak of "Farmers' or other mutual * * * companies." And the term "farmers' mutuals" is descriptive of a definite type of insurance company, one of the class commonly known as local assessment mutuals. These companies furnish insurance coverage on the payment of a cash premium, with the understanding that in the event that additional funds are needed to meet losses and expenses, assessments may be levied upon the members on a *pro rata* basis. See Huebner, Property Insurance (1929), pp. 65–68. Under the familiar rule of *ejusdem generis,* the general term "other" should be construed as referring to companies similar in character to "farmers' mutuals." *United States* v. *Stever,* 222 U. S. 167. Petitioner, however, operates on an entirely different basis, and cannot be regarded as being of the same type as these organizations. It is not an assessment company. It does not, like the ordinary farmers' mutual, make periodic settlements with its members, nor does it confine itself to the distribution or sharing of fire risks among the members alone.

It is reasonable to suppose that in exempting farmers' mutuals and similar organizations, Congress had in mind the fact that such companies normally have no income other than relatively small

amounts received by way of interest on bank balances and the like. Petitioner, however, instead of applying its premium deposits directly to payment of expenses and losses, invests a part thereof and uses the excess income from investments to build up a substantial surplus account. (R. 47, 55–56.) It is, therefore, a profit-making enterprise, and we submit that Congress did not intend to exempt such organizations from taxation.[1]

2. Furthermore, petitioner's income is not "used or held for the purpose of paying losses or expenses" within the meaning of the statutes. True, no dividends have ever been paid by the Company, and it appears that all of its net income has been placed in the so-called "surplus" account, no part of which has, as yet, been distributed. This "reserved surplus" account, however, was far in excess of the unearned premium reserve which is the standard measure of the reserve required both by good insurance practice and by the Pennsylvania law. (R. 53, 71.) See Huebner, Property Insurance, *supra,* pp. 217–221. Petitioner explains this on the ground that the uncertainty of casualty insurance risks justifies extreme caution, and that it

[1] The Senate debates on the question of including fire-insurance companies in Section 231 (11) of the 1926 Act (identical with the provisions presently involved) tend strongly to indicate that only assessment companies were intended to be made exempt, and that for the reason that they were regarded as not being profit-making organizations. Cong. Record, Vol. 67, Part 3, pp. 3431–3436.

is for the officers of the Company to determine how great a reserve should be maintained. But Congress could not have intended that a company should be able to place itself within the exempt class by the unlimited accumulation of surplus at the sole discretion of its officers or directors. This would too readily permit avoidance of taxes at the will of the taxpayer.[2]

The essence of mutuality is membership. The facts in the instant case disclose that it was neither the policy nor the intent of the officers of the Company to share the surplus, in excess of requirements, from time to time with all the policyholders. The policyholders of petitioner, other than the few who had deposited notes, had no rights different from the policyholders of the usual stock fire insurance company. In *Penn Mutual Co.* v. *Lederer*, 252 U. S. 523, 525, 535, this Court stated it "is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder"; also, that the real difference between stock companies and mutual companies is that in the latter, by vir-

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[2] Under Section 234 (a) (9) and (11) of the Revenue Act of 1926, and Section 208 (c) (1) (A) of the Revenue Act of 1928, mutual insurance companies are permitted to deduct only such additions to reserves as are required by law. See also Treasury Regulations 69, promulgated under the Revenue Act of 1926, Article 569; and Treasury Regulations 74, promulgated under the Revenue Act of 1928, Articles 1011 and 1012.

tue of his policy, the insured becomes a member of the company, clothed with all of the rights and privileges and subject to the obligations arising out of this relationship. See also Cooley's Briefs on Insurance (2d Ed. 1927), Vol. I, p. 68; *Atlantic Life Ins. Co.* v. *Moncure,* 35 F. (2d) 360, 362 (E. D. Va.); *Hays* v. *Lycoming Fire Ins. Co.,* 98 Pa. 184. Similarly, in *Baltimore Equitable Soc.* v. *United States,* 3 F. Supp. 427 (C. Cls.), certiorari denied, 290 U. S. 662, and *MacLaughlin* v. *Philadelphia Contributionship,* 73 F. (2d) 582 (C. C. A. 3d), certiorari denied, 294 U. S. 718, the issues were not essentially different from those here involved. The application of the principles set forth in the foregoing decisions is called for in the instant case and sustains the conclusion that petitioner does not qualify for the exemption claimed. Cf. *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232, 235.

Under a ruling of the Bureau of Internal Revenue, petitioner would be taxable on its net income if, in any year, it made a distribution to its members of part of the income derived from its investments. I. T. 2310, V–2 Cum. Bull. 68 (1926). We submit that it should also be taxable if it is in a position to make such a distribution, regardless of whether it actually does so or not. Obviously, petitioner is realizing a substantial profit on its operations. If taxation be deferred until some future time when a distribution is made, only the income received during that year will be taxable,

and the Government will be deprived of the tax on all profits realized in prior years. The statutes should not be construed in a manner which would lead to such a result.

3. Petitioner urges (1) that the court below indulged in judicial legislation in that it revived the provisions of a repealed Pennsylvania statute as a basis for its decision, thus violating petitioner's rights under Section 1, Article I, of the Federal Constitution and also of the due process of law clause of the Fifth Amendment; and (2) that the Circuit Court of Appeals erred in making findings of fact contrary to those of the District Court. We submit that both contentions are without substance.

As will be seen from its opinion the decision of the court below rests upon principles, approved by this Court, as to what constitutes a mutual company within the meaning of the relevant taxing provisions. (See R. 90–91.)

While it is true that the court discussed the provisions of the Pennsylvania Act of 1856, this was done in connection with pointing out petitioner's charter powers and the different methods of conducting its business prior to and after 1914. Manifestly, regardless of petitioner's exact legal status under the laws of Pennsylvania, as originally enacted and as subsequently changed, such status cannot control the application of the Federal Revenue Acts which depend upon the actual practices and

rules of the company in effect during the taxable years involved, and upon "the character of the business actually done." *Bowers* v. *Lawyers Mortgage Co.*, 285 U. S. 182, 188.

Moreover, it is plain that the court below did not err in failing to reach the same conclusions upon the uncontroverted facts as did the District Court. It was clearly open to the Circuit Court of Appeals to draw different legal conclusions from the undisputed facts than were reached by the District Court. Cf. *Helvering* v. *Tex-Penn Co.*, 300 U. S. 481, 493, 495–496; *Helvering* v. *Price*, No. 559, 1939 Term, decided March 25, 1940.

## CONCLUSION

The decision below is based upon established principles and no conflict of decisions is involved. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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JUNE 1940.

# APPENDIX

## STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 103. EXEMPTIONS FROM TAX ON CORPORATIONS.
>
> The following organizations shall be exempt from taxation under this title—
>
> * * * * *
>
> (11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses;
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Section 103 (11) of the Revenue Act of 1932, c. 209, 47 Stat. 169; Section 101 (11) of the Revenue Act of 1934, c. 277, 48 Stat. 680; and Section 101 (11) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are identical with the above-quoted section.

Pennsylvania Laws (1856), No. 236, pp. 211, 214–215:

> SECTION 11. That whenever any company may be incorporated under this law, and may intend to transact its business upon the mutual principle exclusively, or in connection with a jointstock capital, it shall be so designated in its charter; and if upon the mutual principle exclusively, then the parties named in said special act, and their asso-

ciates, shall be made and constituted a body corporate, directly, and without the grant of letters patent, as hereinbefore provided in reference to joint stock companies; and in that case all persons insuring with, and continuing to be insured therein, shall thereby become members during the period they shall remain so insured, and no longer, and shall pay such rates as shall be determined by the board of directors, and be liable for all losses and expenses of said company, to the amount of the premiums paid, or agreed to be paid by said members respectively. * * *

SECTION 12. That the directors of the said companies shall, on the first Monday of January and July in each and every year, declare dividends of profits, as to them shall appear advisable, first deducting all expenses and losses; but the moneys received for premiums upon risks, which remain undetermined and outstanding at the time of declaring such dividends, shall not then be considered as part of the profits, nor divided as such, where said companies are conducted upon the joint stock principle; said dividends shall be paid to the respective stockholders, or to the agents duly empowered to receive them; and when organized upon the mutual principle exclusively, each member shall be entitled to such a proportion of the said surplus, as the cash premium paid by such members respectively may bear to the aggregate surplus so declared; and for the proportionate share of each member so ascertained, a certificate shall be issued, declaring him or them to be entitled to such a portion of the accumulated capital of the company; said certificate to be construed and governed as hereinafter mentioned; but no certificate shall be issued for a less sum than

twenty-five dollars, nor for any fractional part of five dollars, and shall, at the discretion of the directors bear, and be paid interest at a rate not exceeding six per centum per annum. When said companies shall be organized upon the stock and mutual principle jointly, the directors, after ascertaining the surplus as above mentioned, shall first set aside out of the same, six percent. on the actual value of the capital stock of said company; which valuation shall be estimated by the said directors for that purpose, and the balance shall be apportioned among the insured members and the stockholders; and each insured member shall receive certificates as aforesaid, for such a proportion of the said surplus as the premiums paid by him on determined risks may bear to the entire collective amount of stock valued as aforesaid, and premiums earned; and each stockholder shall receive such a proportion of the same, as the stock so valued and held by him may bear to the entire collective amount of said stock and premiums earned.

Purdon's Pennsylvania Statutes (1936), Title 40:

SEC. 363. *Scope of act.* * * * No insurance company heretofore created and to which this act applies shall be deprived of any right which it enjoys under its charter to engage in any business other than insurance. Nothing in this act shall be construed to interfere with the charter provisions or operations of any domestic mutual fire-insurance company heretofore organized under any general or special law of this Commonwealth.

SEC. 364. *Acceptance of act.*—Any insurance company heretofore organized under

any general or special law of this Commonwealth to transact any of the classes of insurance authorized herein, and to which this act does not apply, may transact any one or more of the classes of insurance authorized by section two hundred and two (202) of this act to be transacted by any such insurance company, and become subject to the provisions of this act, by providing the capital and reserve required for such companies organized hereunder, and by filing with the Insurance Commissioner a resolution of the board of directors or trustee, approved by the stockholders or members at a meeting specially called for that purpose, accepting the provisions of the Constitution and of this act, and agreeing to be governed thereby as fully as though organized hereunder. The charters of all insurance companies accepting the provisions of this act shall, after such acceptance, be repealed and of no effect insofar as the same may be inconsistent with the provisions of this act. Any domestic mutual fire company or association may elect to adopt and become subject to the provisions of this act, in lieu of any act or acts heretofore governing such company or association, by resolution of its board of directors, duly approved by a majority of the members present at any annual meeting or special meeting called for that purpose, of which all members shall be given at least two weeks' notice by mail. These resolutions, and the vote approving them, duly certified to by the president and secretary, shall be filed with the Insurance Commissioner, and, when approved by him, the company shall then and thereafter become subject to the provisions of this act.

SEC. 384. *Name of company.*—The subscribers to the articles of agreement of any company to be incorporated under the provisions of this act may adopt any name not previously used by any existing company, but such name must clearly designate the object and purpose of the company. In the case of a mutual company, the word "mutual" must appear in the name or title thereof. * * *

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SEC. 677. *Surplus held as reserve; disposition on dissolution.*—The surplus of any domestic mutual fire insurance companies issuing policies in accordance with the provisions of section one or two of this act shall be held as a reserve for the payment of losses and expenses; and, in the event of dissolution of the company, shall be divided pro rata among the policyholders whose policies are in force at the time of dissolution, but no policyholder, other than loss claimants, shall receive more than the amount of the unearned cash premium last paid to the company for the current term of such policy. Any balance remaining shall escheat to the Commonwealth of Pennsylvania.

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SEC. 917. *Reserves.*—A mutual insurance company, other than a mutual life company, shall maintain unearned premium and other reserves separately, for each kind of insurance, upon the same basis as that required of domestic stock insurance companies transacting the same kind of insurance, except that the Insurance Commissioner may, by written order, fix a different basis of reserve for losses and claim in workmen's compensation insurance. Any reserve for losses or claims based upon the premium income shall

> be computed upon the net premium income, after deducting any so-called dividend or premium returned or credited to the member. * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> Art. 101 (11)–1 [as amended by T. D. 4634, XV–1 Cum. Bull. 127, 1928 (1936)]:
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> To be exempt under section 101 (11) the business of the organization must be purely mutual and its income must be used or held solely for the purpose of paying losses or expenses. Neither the extent of the territory in which the company may properly operate nor the fact that it accepts premium deposits instead of assessments is decisive as to its exemption. The writing of nonmutual insurance regardless of amount will deprive a company of the exemption.

The provisions of Article 101 (11)–1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, are identical with the above-quoted regulations.

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